

interpretation of the statutes, and to begin authorizing competition in the local exchanges. The Supreme Court of Washington affirmed the Superior Court's judgment, in In re Electric Lightwave, Inc., 123 Wn.2d 530, 869 P.2d 1045 (1994), as amended on denial of reconsideration. In that decision, the Supreme Court stated:

RCW 80.36.300(5) notes it is the state's policy to "[p]romote diversity in the supply of telecommunications services and products in telecommunications markets through out the state." Recognizing an implicit authority to grant monopolies would frustrate the express legislative goal of assuring diversity. 123 Wn.2d at 538-539

Several telecommunications companies, including ELI and TCG, have begun to construct local networks and to provide local exchange service, on a limited basis, in competition with incumbent LECs. Three other companies also have been granted authority to provide competitive local exchange service. In this order, these new local service competitors will be referred to as "alternative local exchange companies" or "ALECs."

In order to provide complete local exchange service, the ALECs must be able to interconnect their networks with those of the incumbent LECs. Establishing the terms of interconnection of competing local switched networks is the principal focus of this proceeding. This proceeding involves several complex issues, including the physical terms of interconnection; compensation for terminating traffic that originates on a competitor's network; the possible "unbundling" of services; number portability; use of existing directory assistance databases; unified white pages directory listings; the pricing of services and unbundled network components; and other issues.

USWC, in its tariff filing, and GTE have proposed local interconnection mechanisms that are modeled on mechanisms established during the 1980s for interconnecting with IXC's. Whether these mechanisms are appropriate for local interconnection, whether the incumbent LECs' specific proposals adequately address the state's policy goals, and whether there are alternatives that are more appropriate in terms of meeting the state's telecommunications policies, are matters to be determined in this proceeding.

### C. OVERVIEW OF USWC'S TARIFF FILING

USWC proposes that both the physical and compensation terms of local interconnection be modeled on its access tariff for IXC's. The tariff filing proposes a restructure of access service for IXC's by bringing that service into conformity with an FCC-ordered restructure of the local transport component of interstate switched access service.<sup>4</sup> At the same time, it would bring the ALECs into the access charge structure, creating a unified access structure for both groups of carriers.

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<sup>4</sup> See, CC Docket No. 91-213.

USWC currently assesses IXCs time and distance-sensitive charges for providing the originating or terminating leg of a long distance call. The access charge has several rate elements, including charges for local switching (switching at the end office); local transport (a charge for use of trunk lines that connect USWC's central offices, including transport via its tandem switch); a carrier common line charge as a contribution to the cost of the wire loop that connects to the customer's premises; and a universal service fund charge.

USWC refers to its proposed restructure of IXC switched access service as the "local transport restructure" ("LTR"). In the tariff revisions, the current charge for "transport" would be "unbundled" from the access charge, and transport would be split into several elements which would be individually priced and offered. The unbundling of transport would make use of USWC's transport service optional: an IXC could bypass USWC's transport facilities by providing its own transport to USWC switches or obtaining transport trunks from third parties. USWC would make available alternative transport options either through direct trunked transport or tandem switched transport. The remaining access charges would be modified to increase the switching charge from \$0.0065/minute to \$0.01/minute, and, in order to make the filing revenue neutral, add a temporary rate element that USWC calls a "residual interconnection charge" ("RIC"). The new LTR access charges would apply to all toll traffic, including long distance traffic delivered by ALECs.

For local interconnection, USWC's tariff filing creates a new "local interconnection service" ("LIS") section of its Access Services tariff. The LIS incorporates the transport options and switching charge from the restructured switched access tariff,<sup>5</sup> and creates a new access rate element for local interconnection called an "interim universal service charge" ("I-USC"). The I-USC is applicable to LIS customers that market mostly to business customers and high density service areas. The I-USC would be in the same amount as the carrier common line charge, \$0.0228/local switching minute. Thus, for local traffic that it delivers to USWC for termination, an ALEC would be assessed a local switching charge of \$0.01/minute, an interim universal service charge (I-USC) of \$0.0228/minute, and transport charges for transport services used.

USWC contends that the I-USC is necessary as a *contribution* to USWC for bearing the burden of providing "universal service" (ubiquitous service with affordable residential rates).

The LIS would require the establishment of a formal tracking, measurement, and billing mechanism for local call termination.

As part of its tariff filing, USWC proposes an expanded interconnection service for companies that wish to avoid USWC transport charges by providing their own transport to USWC end office or tandem switches. The FCC has ordered expanded interconnection for

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<sup>5</sup> The LIS does not incorporate the common carrier line charge or the RIC from the LTR.

IXCs. Expanded interconnection would allow interconnection at USWC tandem and local switches. It would use a co-location ("collocation") arrangement whereby companies interconnect with USWC's network on USWC's premises, with USWC providing space for the interconnector to locate its terminating equipment. USWC's tariff specifies facilities that the interconnector must use, and specifies a number of charges for the service. Expanded interconnection would be offered to ALECs as well as IXCs.

USWC has rejected the ALECs' requests to interconnect with USWC's network at any convenient "meet point," or in the same manner it interconnects with incumbent LECs for the exchange of EAS traffic. USWC would permit an ALEC to interconnect only inside or just outside the ALEC's central office, using a USWC entrance facility, or just outside a USWC central office, via virtual collocation.

USWC proposes to offer several services that would make it easier for USWC's customers and the ALECs' customers to reach one another. These other services include white pages directory listing; directory assistance services; use of USWC's line identification data base (LIDB) which facilitates billing for third-party, collect, and calling card calls; a channel to the customer's premises; and interim solutions to number portability while permanent solutions are being developed. For the most part, these services would be provided through USWC's existing tariffs at already established rates.

#### D. THE COMPLAINTS

The complaints by ELI and TCG allege generally that USWC and GTE refuse to enter into interconnection and mutual compensation arrangements with complainants that are equivalent to the arrangements the incumbents have made with other LECs for the exchange of local/EAS traffic. Further, the incumbents propose to charge the complainants for interconnection at rates well in excess of rates they charge their own customers for comparable local exchange services, thereby subjecting the complainants to unreasonable prejudice, discrimination, and disadvantage. The complaints also allege that the incumbents' proposed charges for network interconnection are unfair, unjust, unreasonable, and anticompetitive. They ask the Commission for orders pursuant to RCW 80.36.140 and 80.36.160 requiring the incumbents to interconnect their networks with the complainants' networks, establishing a fair, just, reasonable, and nondiscriminatory reciprocal compensation arrangement for that interconnection, and requiring the incumbents to provide 9-1-1, directory listings and assistance, and other vital customer services upon interconnection at fair, just, and reasonable rates. The complaints are described in greater detail in section II.G. of this order.

GTE also has brought a third party complaint against USWC, claiming that USWC is handing off to GTE, for termination, traffic that originated on TCG's network that GTE is entitled to be compensated for terminating, without identifying the traffic so that GTE can bill for it. The reference is to traffic that would be EAS traffic if it originated on USWC's network.

### E. OVERVIEW OF POSITIONS OF PARTIES

With respect to local interconnection, the parties generally split into two groups. All parties except the incumbent LECs generally oppose USWC's tariff proposals and GTE's proposed rates as requiring unnecessary and inefficient architecture, as unproven, as unfair and unreasonable, as discriminatory, and as anticompetitive.

With regard to compensation for terminating an ALEC's traffic, the opponents of USWC's proposal are particularly critical of the proposed I-USC. All urge the Commission to defer consideration of universal service to another proceeding.

All of these parties, except one (AT&T), oppose the compensation mechanism the incumbents propose for the mutual termination of local traffic -- measured usage rates. They, as well as AT&T, argue that the appropriate compensation arrangement for the mutual termination of local traffic between competing LECs, at least until barriers to competition are removed, is "mutual traffic exchange" known as "bill and keep," the compensation arrangement that the incumbent LECs presently utilize for the exchange of EAS traffic. The complaints, in fact, allege that it is discriminatory for the incumbents to adopt any other compensation mechanism while they have a bill and keep arrangement among themselves.

The ALECs argue that USWC's proposal to restrict physical interconnection to three points and via specified facilities is unreasonable and anticompetitive, and urge the Commission to order USWC to allow them to physically interconnect with USWC's network at meet points similar to those established between incumbent LECs.

They also argue that competition will develop more quickly if they are able to purchase and resell unbundled parts of the incumbents' networks, although they differ over the degree of unbundling that is necessary. These parties agree that at a minimum they should be able to lease the customer loop (the link between a customer's residence or place of business and the end office switch) from an incumbent LEC for resale to end users, so that the competitors can provide service without the need to duplicate the loop to every end user's premises. They contend that the Commission must establish other terms of interconnection that are necessary to effective competition.

Allied on the other side are the incumbent LECs -- USWC, GTE, and the Washington Independent Telephone Association (WITA). They generally take the position that the Commission's authority with respect to interconnection is limited to ordering the incumbents to interconnect, and regulating the fairness and sufficiency of the rates for the interconnection services the incumbents choose to offer. They contend that bill and keep, additional physical interconnection options, greater unbundling than the LECs are willing to offer, and other solutions proposed by the other parties are beyond the Commission's authority to order and that ordering them would constitute confiscation of the incumbent LECs' property. They contend that very few of the services and facilities their opponents request are necessary for effective competition, and that their competitors are asking the Commission for competitive assistance and advantage. USWC opposes deferral of the universal service question on

policy and legal grounds, and the other incumbents support its contention that it is entitled to an I-USC element in its access charge. WITA contends that unbundling may not be cost effective for small LECs.

Responding to the complaints, USWC contends that the complaints raise no issues not also raised in USWC's direct case and presented by USWC for resolution, and should be dismissed as moot. GTE contends that the complaints against it must be dismissed because the complainants have not stated actionable claims or proven their case, and contends that because the complaints must be dismissed, the Commission cannot enter an order regarding GTE's rates in this proceeding.

GTE contends that several issues in USWC's tariff proceeding, including unbundling, universal service, and collocation, were not raised in the complaints against GTE, and that the Commission cannot enter any order with respect to GTE on such issues.

With respect to the LTR, the IXCs, which are particularly dependent on incumbent LEC transport and switching for the local leg of long distance calls, support the LTR's separation of transport from other elements of access service, and support the component elements of transport that USWC has identified, but strongly oppose the LTR's proposed pricing of the transport elements, the proposed increase in local switching charge, and proposed residual interconnection charge (RIC).

The IXCs that are parties -- AT&T, MCI, Sprint, and IAC -- take the common position, via a stipulation, that revisions to the switched access tariff (i.e., the LTR) should be resolved in another proceeding that currently is pending before the Commission: the USWC general rate case (Docket No. UT-950200).

In addition to the ALEC objections to USWC's requirement that interconnection at USWC end offices may be only via USWC's virtual collocation service, several parties raise concerns about the charges USWC proposes to impose for virtual expanded interconnection services, and USWC's proposal to price other elements of ALECs' charges on an Individual Cases Basis ("ICB").

A number of parties analyze the cost studies on which USWC bases its rate proposals, and are highly critical of them. They contend that the studies use improper measures of economic cost, are unnecessarily cryptic, contain strategically differentiated markups over cost, and are accompanied by insufficient documentation to enable them to conduct a fair review of the company's costs. All parties except the incumbent LECs are critical of USWC's proposed prices for both competitive and monopoly services.

## F. COMMISSION'S JURISDICTION

USWC takes an extremely legalistic approach in support of its tariff proposals and in opposition to the proposals of the ALECs and IXC's. Essentially, it contends that the Commission's authority is limited to ordering interconnection between incumbent LECs and other wireline carriers,<sup>6</sup> and reviewing for fairness and sufficiency the rates for the interconnection services it offers.

USWC makes a detailed analysis of the Commission's statutes. It argues, based on its analysis, that:

- (1) The Commission must approve access or interconnection charges (as in the current interexchange model) for local interconnection. Commission statutes do not allow the prescription of no rates, or bill and keep. Commission statutes all contemplate that remunerative rates will be charged.
- (2) Although incumbent LECs exchange EAS traffic on a bill and keep basis, the Commission has no authority to require companies to provide intercompany EAS on a bill and keep basis.
- (3) Given the state's telecommunications policies, the Commission has no choice but to approve an access charge structure for local interconnection with a universal service charge element. Failure to approve USWC's proposed I-USC would either undermine affordable universal service, which is the state's paramount public policy under RCW 80.36.300, or would illegally deprive USWC of the ability to cover its authorized revenue requirement.
- (4) The Commission only has authority to order a company to provide telecommunications services to another. It has no authority to order a company to provide bare facilities, such as loops or subparts of loops. It cannot order unbundling.
- (5) The Commission's jurisdiction to regulate in terms of competitive fairness applies only to rates for telecommunications services. It does not provide authority to order charges for or access to bare facilities, real estate, or non-telecommunications products or services such as telephone directories.

The other incumbent LECs (GTE and WITA) make many of the same arguments.

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<sup>6</sup> None of the LECs deny that they must interconnect with local exchange service competitors for the exchange of traffic. USWC notes that Const. art. 12, § 19 requires it to interconnect. WITA notes that 80.36.350 empowers the Commission to authorize the entry of new companies, and that once operating, 80.36.200 provides that a new company's messages must be received, transmitted, and delivered by other telecommunications companies without discrimination or delay.

The Commission is mindful that it is a creature of the Legislature without inherent or common-law powers, and that it may exercise only those powers conferred on it either expressly or by necessary implication. Cole v. Wn. Util. & Transp. Comm'n, 79 Wn. 2d 302, 306, 485 P.2d 71 (1971).

The Commission believes that the telecommunications industry itself should assume primary responsibility for reaching consensus on reasonable solutions to many of the local interconnection issues. However, we realize that the industry necessarily and appropriately looks to the Commission to provide some leadership and direction during the transition to a competitive industry structure. If members of the industry fail to reach agreement necessary to resolve these critical issues, the Commission is prepared to take a more directive role as needed to establish terms for fair interconnection among competing providers of local exchange services.

The Commission has carefully and thoroughly considered the incumbent LECs' arguments that we lack authority to order any interconnection terms or conditions other than those they are offering. We believe that the incumbent LECs' interpretation of the Commission's authority, and USWC's interpretation in particular, are unreasonably restrictive. The Commission has broad authority to regulate the rates, services, facilities, and practices of telecommunications companies in the public interest. See, POWER v. Utilities & Transp. Comm'n, 104 Wn.2d 798, 808, 711 P.2d 319 (1985); State ex rel. American Telechronometer Co. v. Baker, 164 Wash. 483, 491-96, 2 P.2d 1099 (1931); State ex rel. Public Service Commission v. Skagit River Telephone & Telegraph Co., 85 Wash. 29, 36, 147 P. 885 (1915).

Under RCW 80.01.040(3), the Commission is authorized to regulate in the public interest the rates, services, facilities, and practices of public utilities, including telecommunications companies.

RCW 80.36.080 gives the Commission broad power to regulate the rates, tolls, contracts and charges, rules, and regulations of telecommunications companies for services rendered and equipment and facilities supplied, as to fairness, justness, reasonableness, and sufficiency.

RCW 80.36.140 gives the Commission broad authority over rates and over rules and practices affecting rates, and broad authority over practices, facilities, and services:

Whenever the commission shall find, after a hearing had upon its own motion or upon complaint, that the rates, charges, tolls or rentals demanded, exacted, charged or collected by any telecommunications company for the transmission of messages by telecommunications, or for the rental or use of any telecommunications line, instrument, wire, appliance, apparatus or device or any telecommunications receiver, transmitter, instrument, wire, cable, apparatus, conduit, machine, appliance or device, or any telecommunications extension or extension system, or that the rules, regulations or practices of any

telecommunications company affecting such rates, charges, tolls, rentals or service are unjust, unreasonable, unjustly discriminatory or unduly preferential, or in anywise in violation of law, or that such rates, charges, tolls or rentals are insufficient to yield reasonable compensation for the service rendered, the commission shall determine the just and reasonable rates, charges, tolls or rentals to be thereafter observed and in force, and fix the same by order as provided in this title.

Whenever the commission shall find, after such hearing that the rules, regulations or practices of any telecommunications company are unjust or unreasonable, or that the equipment, facilities or service of any telecommunications company is inadequate, inefficient, improper or insufficient, the commission shall determine the just, reasonable, proper, adequate and efficient rules, regulations, practices, equipment, facilities and service to be thereafter installed, observed and used, and fix the same by order or rule as provided in this title.

Under RCW 80.04.110, the Commission may consider complaints by one competitor against another alleging that the rates, charges, rules, regulations, or practices of the other are unreasonable, unremunerative, discriminatory, illegal, unfair, or intending or tending to oppress the complainant, to stifle competition, or to create or encourage the creation of monopoly, and to correct abuses complained of by establishing uniform rates, charges, rules, regulations, or practices in lieu of those complained of.

RCW 80.36.160 gives the Commission authority to order physical connections, prescribe routing, and establish joint rates for toll telephone service.

Finally, the Commission has broad powers to protect consumers and competitors from unreasonable preference, advantage, or discrimination under RCW 80.36.170, .180, and .186.

Our analyses of the incumbent LECs' specific legal arguments concerning bill and keep, EAS, unbundling, and making available other services and facilities, are set out later, in appropriate sections of this decision. We have concluded that the Commission's authority is sufficiently broad for it to order compensation arrangements (including "bill and keep") and other terms and conditions for local interconnection that differ from those the incumbents propose. In deciding which arrangements, terms, and conditions to approve and order, the Commission will endeavor to identify solutions that are consistent with the state's telecommunications policies and otherwise in the public interest.

## **II. LOCAL INTERCONNECTION**

### **A. POLICY**

The Commission requested that the parties address policy considerations in their testimony and in their briefs. We appreciate the considerable thought and effort the parties put into their discussions.

USWC's policy discussion is largely restricted to its various legal challenges to the Commission's authority to do anything more than review the fairness and remunerativeness of the rates it proposes, summarized in the previous section. USWC's view would permit the Commission virtually no policy role.

The incumbent LECs suggest that the Commission take care not to promote competition solely for the sake of competition. Competition already is developing rapidly on its own, they argue, and many of the measures that the new entrant ALECs seek in this proceeding are unnecessary and would distort competition. The incumbent LECs argue that the ALECs should not be allowed to use the Commission's regulatory authority to gain an unfair advantage in their competition with them.

USWC argues that the Legislature has declared preservation of affordable universal telecommunications service to be the paramount public policy. Other objectives, such as promoting diversity of supply in telecommunications services, are subservient to universal service. USWC maintains that the Commission cannot promote local exchange competition at the expense of affordable universal service and the right of regulated companies to reasonable and sufficient rates for services rendered.

GTE argues that the Commission's overall policy should be to allow the fair and natural development of competition under symmetrical regulatory rules. It should not attempt to create "pseudo-competition," and it should not mandate that some firms aid and provide an advantage to their competitors. GTE argues for interconnection rates that are consistent with sound economic principles and facilitate movement toward an integrated, unified rate structure for all traffic between carriers, be they incumbent LECs, ALECs, or interexchange carriers.

WITA's position stresses the need to avoid delay in defining standards for local exchange competition, because the development of competition in this market is already explosive. According to WITA, the Commission should recognize the conditions claimed by ALECs as requirements for competition as mere illusion, designed to gain a competitive advantage. WITA argues that each new entrant could, if it so chooses, completely duplicate the existing network of the incumbents or use existing wireless or cable infrastructure.

Other parties in this proceeding generally argue that the paramount policy of the Commission should be to permit and encourage the development of effective competition in the local exchange market. Commission policy should support arrangements that are consistent with competitive markets and that promote the development of efficient, low-cost services for consumers. Competition, they argue, promotes the public policies declared by the Legislature in RCW 80.36.300, such as universal service and diversity of supply.

The other parties offer recommended sets of policies that differ in scope and detail but generally resemble each other in comparison to the incumbent LEC positions. For example, Commission Staff offers a series of principles and objectives intended to move toward a long term goal of establishing the marketplace as the regulator of local rates and services. These include policies to promote effective competition, treat all market participants as "co-carriers," require that dominant incumbents make available to ALECs non-competitive services at non-discriminatory, cost-based, unbundled rates, recognize the lack of "effective competition" in defining "essential services," require that prices for basic network functions be cost-based without contribution to the profits of the incumbent, and use total service long run incremental costs (TSLRIC) as the cost basis for pricing decisions.

The Commission concludes that the decisions in this case must be guided primarily by the specific public policies declared by the Legislature in RCW 80.36.300:

- (1) Preserve affordable universal telecommunications service;
- (2) Maintain and advance the efficiency and supply of telecommunications service;
- (3) Ensure that customers pay only reasonable charges for telecommunications service;
- (4) Ensure that rates for noncompetitive telecommunications services do not subsidize the competitive ventures of regulated telecommunications companies;
- (5) Promote diversity in the supply of telecommunications services and products in telecommunications markets throughout the state; and
- (6) Permit flexible regulation of competitive telecommunications companies and services.

These legislative policies are, in turn, guided by provisions of the state constitution that protect the rights of all companies to provide telecommunications services (Const. art. 12, § 19) and declare the state's abhorrence of monopolies (Const. art. 12, § 22). See, In re Electric Lightwave, Inc., supra, 123 Wn.2d at 538-39.

The policy goals of preserving universal service and promoting competitive markets are not at odds. Competition can make telecommunications services more affordable by encouraging firms to be more efficient and more innovative. It also can promote affordable service by imposing "market discipline" on the prices of incumbent LECs in other words, the prospect of competition can encourage incumbents to hold down rates.

As the Commission moves forward in establishing the conditions for competition (as presented to us in this docket), we must be vigilant in regards to consumer protection and universal service goals. To this end, the Commission concurs with the principles advocated by Public Counsel, at pages 3-4 of its brief:

The first policy is that the Commission should guarantee that the benefits of competition -- including lower rates, more and better service options, and more rapid deployment of technological advances -- flow to all customers, not just large business customers.

The second, and corollary policy is that the Commission assure that residential and small business customers do not become the "guarantors" of US WEST's revenue stream at a time when competitive pressures would otherwise force the Company to become more efficient to maintain its levels of profitability.

The third policy is that new entrants be recognized as co-carriers and treated accordingly. The Commission should dismantle any remaining barriers to entry and avoid constructing (or authorizing incumbents to construct) any new barriers through decisions on interconnection issues.

The Commission adds the additional principle that rates and conditions should reflect costs. The Commission continues to be mindful of the statutory requirement that rates be fair, just, reasonable and sufficient. It would not be in the public interest to allow rates which do not meet this test.

## B. COMPENSATION

### 1. Introduction

The crux of this case deals with inter-company compensation for the termination of local calls. Little would be gained from granting new firms the opportunity to interconnect with the existing network but allowing the incumbents to charge excessive rates for that access. Yet it also would not be in the public interest to establish a compensation mechanism that failed to compensate companies for the use of their facilities, that allowed new entrants to impose excessive costs on incumbents' networks, or that created incentives for uneconomic investment.

In evaluating alternative compensation mechanisms we have sought to maintain a balance between the objective of promoting diversity in the supply of telecommunications services and the responsibility to ensure that companies are fairly compensated for their services. It is not the Commission's responsibility to protect incumbents from competition; indeed, it is our responsibility to ensure that new entrants have a reasonable opportunity to compete. We emphasize our agreement with the incumbent LECs that we should not encourage competition merely for the sake of competition. We seek to ensure the

development of effectively competitive markets in order to satisfy consumer demand and promote economic efficiency.

## **2. Options Presented**

The parties have put forward three different approaches for compensating local service providers for terminating a competitor's local calls: (1) a variable charge based on minutes of use of the terminating company's transport and switching network; (2) compensation in the form of mutual traffic exchange, or "bill and keep"; and (3) a port charge based on peak use of interconnection capacity.

USWC in its tariff filing and GTE in the rates it has offered to the complainants, take a common approach of a per-minute charge mechanism. This proposed compensation mechanism is an access charge structure modeled on the one adopted in the 1980s for interconnection with IXC's.

Mutual traffic exchange, or bill and keep, is the preferred alternative of nearly all the other parties, at least as an interim approach until barriers to competition are removed. Bill and keep is a compensation mechanism in which each local exchange company would pay for the calls it terminates on other companies' networks by, in return, terminating those other companies' calls on its own network.<sup>7</sup>

The flat-rated port charge was proposed by several parties as an alternative to per-minute charges, should the Commission reject a bill and keep mechanism.

### **a. Per-minute charge**

In the tariff revisions filed in this proceeding, USWC proposes to charge essentially the same unbundled rates for transporting and terminating calls from local competitors as it would charge IXC's for switched access (long-distance) transport and call termination. The local interconnection service (LIS) section of USWC's Access Services tariff would incorporate transport rates and a switching rate element from the company's restructured switched access tariff for IXC's, and would add an interim universal service charge (I-USC) rate element.

For local traffic that an ALEC delivers to USWC for termination, USWC would assess the ALEC transport charges for USWC transport services the termination requires, a local switching charge of \$0.01/minute for use of the end office switch, and an I-USC of \$0.0228/minute applicable to ALEC's that do not meet a set of requirements that includes serving the same ratio of residence to business customers as USWC. USWC proposes the I-USC as a contribution to the support of USWC's statewide averaged residential rates.

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<sup>7</sup> TCG favors bill and keep for end office interconnection only; it proposes that interconnection at tandem switches be compensated with port charges.

USWC's LIS would require that local traffic be measured. USWC presently is not capable of measuring terminating local traffic, but is developing new technology that can generate the necessary call records for such measurement. It proposes interim measurement arrangements whereby each local exchange company would measure the traffic it delivers to another, and the receiving company would rely on those measurements to bill its terminating access charges. USWC presently bases IXC access charges on a delivered-traffic reporting system similar to the interim system it proposes for ALECs.

USWC proposes that local interconnection access charges be reciprocal. The ALECs could charge USWC access charges for traffic that USWC delivers to them for termination to ALEC customers based on the ALECs' access tariffs or price lists. An exception to this position is USWC's proposed I-USC. It would be strictly a one-way charge.

GTE has proposed usage-based mutual compensation for terminating ALECs' "local-like" and "EAS-like" traffic based upon GTE's switched access tariff rates, except for the common carrier line charge and the information surcharge elements.<sup>8</sup> Its proposed contract rate for local termination is \$0.0295291 per minute, which is derived from its switched access tariff. In cross-examination, GTE witness Beauvais recommended that the Commission should direct GTE to impose rates for inter-company compensation at a level similar to what is paid currently for local measured service, approximately \$0.01 to \$0.015/minute. [Beauvais, TR., pp. 1789 and 1802] GTE has not proposed to unbundle transportation from its access charge.

There were several basic issues cited by parties in their support for or opposition to a measured use structure. The major issues were whether: (1) the local access rate structure should be consistent with the existing toll access rate structure; (2) a per-minute charge would send correct economic signals to actual and potential participants in the market; and (3) measured use rates would impose unnecessary costs on market participants.<sup>9</sup>

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<sup>8</sup> GTE does not have a tariff for local interconnection service, either existing or proposed. GTE is a party in this proceeding because of complaints filed against it by TCG and ELI. In negotiations with GTE, TCG and ELI requested that GTE interconnect with them on the same basis it interconnects with incumbent LECs for the exchange of EAS traffic, including employing a bill and keep method of mutual compensation for the exchange of local traffic. GTE refused that request.

<sup>9</sup> The parties also disagree about the amount that would be charged per minute for call termination. USWC contends that interconnection rates should be set above incremental cost to provide a contribution to the common costs of the existing network. Several other parties argue that rates should be set at incremental cost to promote competition. Markups on services provided to competitors would allow the incumbent to block meaningful competition, they argue.

(1) Consistency of local and toll access rate structures.

USWC argues that there is no basis for having a different compensation mechanism for local traffic than the one already in place for interexchange traffic. Local interconnection is no different technically and conceptually from any other kind of interconnection. GTE concurs in this argument, contending that differentiation of traffic "types" will succumb to the proliferation of technologies, service providers, and service packages. A common rate structure would obviate the need to use separate trunking or specialized measuring and billing systems, provide equal treatment to all originating companies, and eliminate the incentive to arbitrage any difference between different rates. In addition, WITA argues that measured use rates for local interconnection build on existing models and are easy and efficient to administer.

In opposition, Public Counsel argues that the historical existence of such a structure for toll access does not make it an appropriate model for local access. DOD/FEA notes that the idea of consistency is superficially attractive but contends that the relationship between an incumbent LEC and a toll carrier is altogether different than the relationship between two incumbent LECs or between an incumbent LEC and a new entrant ALEC.

(2) Economic signals to market participants.

GTE argues that measured use rates for local and EAS traffic send appropriate economic signals to the market. Local exchange companies incur costs to terminate each other's traffic, and this cost should be reflected in rates. The per-minute rate is superior to bill and keep, GTE argues, because bill and keep sends an incorrect economic signal that traffic termination has no cost. USWC also argues that per-minute measured use rates are warranted by the need to send accurate price signals. WITA contends that access-like charges will ensure entry on an economically sound basis and allow rural LECs an opportunity to recover network costs for serving all of the rural service area.

ELI argues that interconnection costs are not sensitive to the number of minutes used but rather are a function of the potential demand for peak network capacity. (Montgomery, Ex. T-84, pp. 47-48)

Public Counsel contends that a measured rate structure has the potential to place irresistible pressure toward provision of retail service on a measured basis. It cites the testimony of GTE witness Beauvais, that "if compensation costs are on a minute of use or per call basis, it is desirable that the end user see a rate structure reflecting those cost characteristics..." (Ex. T-130, p. 12) MCI argues that adopting a per-minute charge, even at cost, would result in a cost floor for local exchange services much higher than the floor that would apply under mutual traffic exchange.

GTE does not accept that usage based charges would result in mandatory local measured service. GTE does not have the goal of imposing mandatory measured service, and its proposed integrated rate structure would accommodate flat rate service offerings.

GTE argues that such concerns should not distract from the real issues of sound economic, forward-looking prices. [Beauvais, TR., p. 1786]

(3) Imposition of unnecessary costs with a per-minute structure.

Finally, the parties disagree on whether the proposed rate structure would unnecessarily raise costs for various firms, either by creating measurement and billing costs or by distorting choices in network architecture and technology. USWC contends that the investment necessary to measure terminating traffic is necessary for companies to manage their networks in a competitive manner and that the additional cost of local measurement capability for companies who already must measure toll traffic is modest and incremental. GTE argues that any factual basis for the claim that measuring costs are high are based only on USWC's costs, citing evidence that it can and is measuring and billing for terminating traffic using existing capabilities at a low cost. WITA suggests that costs could be very low if companies used the Data Distribution Center to exchange billing system records.

Many opponents of USWC's proposed rate structure cite measurement costs as a disadvantage of that proposal. TRACER presented testimony that USWC's assumed costs for measuring, billing, and collecting would account for almost half the costs for terminating local calls. (Zepp, Ex. T-151, 22-23) The technology used to measure local traffic is three times as costly as that used to measure IXC traffic. (Wilson, Ex. T-154, p. 32) Measurement costs will be wasted if traffic is in balance, TCG argues, and even if the traffic is out of balance, the total cost of measurement must be justified by the amount of the imbalance. Sprint, ELI, MCI, and Public Counsel argue that requiring new entrants to adopt technologies that permit measurement of terminating minutes would distort technology and architecture choices and raise entry costs.

b. Mutual traffic exchange

Mutual traffic exchange, also known as "bill and keep," is the compensation mechanism supported by most parties other than the incumbent local exchange companies. Under this mechanism, traffic is exchanged among companies on a reciprocal basis. Each company terminates the traffic originating from other companies in exchange for the right to terminate its traffic on that company's network.

Proponents focus primarily on the reciprocal nature of mutual traffic exchange and the "co-carrier" treatment it affords incumbent LECs and new entrant ALECs. Commission Staff argues that it is appropriate to treat ALECs as co-carriers of local traffic, along with USWC and other LEC incumbents. The new entrants will provide the same local exchange services to their customers as does USWC to its customers. Staff cites as an example the independent LECs, which have used a bill and keep arrangement with USWC for several years. This relationship is in contrast to the IXCs, which are customers of USWC and have historically provided profits to USWC through access charges. ELI, MCI, Public Counsel, AT&T, and TRACER also argue that the reciprocal nature of bill and keep is appropriate because it treats incumbents and entrants as equals in the local exchange market. These

parties contend that the reciprocal nature of bill and keep means that companies do not use the networks of another for free. Consideration takes the form of a payment in kind.

A second argument made by proponents of bill and keep is that it is efficient and simple to administer. Commission Staff, TCG, ELI, Public Counsel, and MFS argue that under this mechanism, neither party incurs measurement and billing expenses, and each company has a strong incentive to minimize its costs and improve the efficiency of its network. AT&T notes that cost studies are avoided. MCI cites the use of mutual traffic exchange among non-competing LECs for terminating EAS traffic as evidence of the efficiency of this compensation structure. It argues that in these situations, where competitive advantage is not sought, adjacent incumbent LECs have chosen bill and keep as the most efficient mechanism.

A third argument made by proponents of bill and keep, including MFS, TRACER, and DOD/FEA, is that it eliminates incentives to perpetuate traffic imbalances. This argument holds that an incumbent LEC would have an incentive under a measured use scheme to delay implementation of local number portability since without number portability, customers are less likely to switch their incoming lines to a new service provider. A bill and keep arrangement would give incumbents an incentive to negotiate better long-term solutions and to develop a workable system of number portability.

The incumbent local exchange companies oppose a bill and keep compensation structure, arguing that it would fail to compensate them for use of their networks by competitors. GTE refers to this arrangement as "forced barter" and argues that it does not satisfy the obligation to make just compensation. USWC similarly argues that "every carrier is absolutely entitled to reasonable and sufficient rates for services rendered" and that the bill and keep arrangement does not provide that compensation.

GTE further argues that full and just compensation would not result under bill and keep unless there were an exchange of equal value and that this is unlikely under bill and keep. Exchange of equal value would require that traffic between two companies be perfectly in balance, and there is no evidence that this would be the case, according to GTE.

Another argument raised by opponents is that the bill and keep structure would invite arbitrage of the differences in rate structure between toll and local access. WITA argues that bill and keep would give even small customers an incentive to establish their own local exchange company. Rather than pay the incumbent LEC for PBX trunks, the customer could obtain bill and keep interconnection service.

The bill and keep structure also is criticized for sending price signals that are inconsistent with the development of an efficient competitive telecommunications market. GTE argues that prices should reflect costs. Bill and keep sets a zero price for terminating local traffic, when that service has a cost. (Beauvais, Ex. T-133, p. 10) WITA makes a similar argument, quoting USWC witness Harris that "the central tenet of economics is that

prices pay a critically important role in the allocation and distribution of goods and services in a market economy. Bill and keep violates that principle." (Ex. T-31, p. 9)

c. Flat-rated port charge

Besides mutual traffic exchange, the other alternative to the per-minute regime proposed by USWC and GTE is a "flat-rated port charge" for interconnection.<sup>10</sup> As described by TRACER witness Zepp, companies would pay a charge for each port interconnecting the other. In effect, the total cost of each port would be allocated based upon use of that port during the period of peak demand. The company with the greater number of terminating minutes during the busy hour would pay an amount based on the difference in minutes and the cost of the interconnection.<sup>11</sup> (Ex. T-151, pp. 19-20) Commission Staff witness Wilson also supported this formulation of a port charge as an alternative to "bill and keep." (Ex. T-155, p. 31)

Commission Staff, TRACER, and ELI support mutual traffic exchange as the preferred compensation mechanism but argue for a port charge as the second-best alternative. TCG advocates a hybrid approach using bill and keep for end office interconnections and a port charge for tandem interconnections. However, no party offers a port charge as its preferred method of structuring compensation.

The record in this proceeding is, to put it euphemistically, rich with argument and evidence on the advantages and disadvantages of the per-minute charge and bill and keep alternatives. Very little information has been provided by the parties on the merits and demerits of a port charge. In support of a port charge over a per-minute charge, Commission Staff and ELI contend that a port charge would result in cost-based rates that are more competitively neutral than per-minute charges. Another suggested advantage of

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<sup>10</sup> While this option is styled a "flat-rated charge," it would be more accurate to describe it as a peak use charge. If the charge were truly "flat-rated," it would not vary with a carrier's use of peak capacity. For instance, flat-rated local telephone service in this state means that a customer pays a flat monthly rate whether or not they make local calls. The port charge proposed in this case is a charge based upon use, but only use during the period of peak demand.

<sup>11</sup> The proposed port charge formula is

$$\text{Price/Port} = 9,000 \times (F_{\text{ALEC}} - F_{\text{USWC}}) \times (\text{TSLRIC} - X)$$

where:

$F_{\text{ALEC}}$  = the fraction of traffic a typical ALEC terminates on USWC during the busy hour, plus or minus 5%,

$F_{\text{USWC}}$  = the fraction of traffic that USWC typically terminates on a ALEC during the busy hour, plus or minus 5%,  
and

$(\text{TSLRIC} - X)$  = the TSLRIC (minus an adjustment factor), expressed in dollars per minute. The per-minute rate is multiplied by 9,000 minutes per month to arrive at a monthly rate.

port charges, compared to per-minute charges, is that this mechanism would avoid many of the expenses of metering, billing, and auditing every minute of use. Charges would be based on peak traffic instead.

In addition, contend Commission Staff and ELI, a port charge is economically efficient, in that it recognizes that interconnection costs are determined primarily by demand for peak network capacity and that off-peak use has very little cost. TRACER and ELI argue that port charges also allow new entrant ALECs more flexibility (relative to measured use rates) to experiment with their own pricing plans. Finally, TCG argues that port charges allow each company to obtain compensation for the costs of interconnection on a basis that parallels flat-rated retail pricing.

### **3. Commission Discussion and Decision -- Compensation**

The structure of a compensation mechanism, as well as the level of interconnection rates, has been argued and examined in great detail in this proceeding. The Commission finds itself impressed with the weaknesses of both USWC's proposed per-minute charge and the mutual traffic exchange mechanism offered by other parties. The record demonstrates that neither mechanism would provide a long-term compensation structure that meets the policies and objectives discussed earlier in this order. This discussion will explain that conclusion, provide for an interim compensation mechanism, and provide the parties with direction on how a long-term compensation structure should be developed.

#### **a. The proposed minutes-of-use structure**

The Commission rejects USWC's proposal to impose toll-type access charges on each minute of local interconnection. Neither the structure of the proposed mechanism nor the specific rates proposed can be considered to be fair, just, and reasonable. Adoption of a minutes-of-use scheme would either impose extremely high barriers to entry or substantially increase the retail price of local service. Either result would conflict with state policy goals. Our rejection of the proposed minutes-of-use structure and rate is based on three basic factors:

- (1) Attempting to unify rate structures in the toll and local access markets by imposing toll-type charges on local access is misguided and unnecessary.

The incumbent LECs look to their existing relationships with the interexchange carriers as a model for their future relationships with competitive alternative local exchange companies. USWC argues that one of two fundamental principles supporting its usage-based pricing structure is that "local interconnection is no different technically and conceptually from any other kind of interconnection" (USWC brief, p. 29). Since local and toll access are technically similar, it is argued that rates structures should be the same. With the IXC rate structure already in place, the incumbent LECs appear to believe the best strategy is to apply that structure to the new entrant ALECs.

The Commission believes it would be a fundamentally misguided strategy to emulate the toll access structure in local exchange interconnection or to make consistency between toll and local access rates an objective in developing an interconnection compensation structure. It should be recalled that toll access rates were developed in a regulatory setting to provide consistency between retail toll rates and wholesale toll access rates. It remains unclear whether the use of measured toll access rates to recover non-traffic-sensitive costs will be competitively sustainable and economically efficient over the long term.

Since the toll access charge regime reflects retail rate structures in wholesale rates, following the toll example means developing a local interconnection regime that reflects the structure of retail local rates. In concrete terms, this means that local interconnection would be available on a flat-rated basis. It would not preclude a measured service option, but it would preclude mandatory measured service at the wholesale level.

- (2) Measured use interconnection rates are not cost-based, because the costs of interconnection generally do not vary with the level of traffic being exchanged.

USWC's second "fundamental principle" underlying its usage-based compensation scheme is that "interconnection rates should be cost based." USWC brief, p. 29. According to the incumbent, "the monopoly era approach of allocating large amounts of revenue requirement to interconnection rates to keep all residential rates below cost is not viable going forward." *Id.*, p. 30.

That argument, whatever its merits, speaks to the *level* of interconnection rates and says nothing about the *structure* of rates. On the issue of rate structure, USWC's brief cites its witness, Mr. Owens, who testifies that one implication of this principle of movement toward economically rational pricing was "the adoption of interconnection rate structures that are reflective of how costs are incurred." (Ex. T-10, p. 5) He then concludes:

Thus, local switching costs imposed by the termination of traffic on a USWC switch from an alternative exchange carrier are appropriately recovered through usage sensitive charges -- not through bill and keep or flat-rated port charges. (Ex. T-10, p. 5)

Missing from USWC's case is the evidence that shows usage-based rates are "reflective of how costs are incurred." By USWC's reasoning, only if costs are primarily traffic sensitive would USWC's support of usage-based rates be consistent with its principle that rate structures reflect how costs are incurred. The record does not support USWC on this point.

Instead, the record shows that usage-based prices are anything but consistent with the underlying costs. Call termination costs are primarily a function of the capacity required to meet peak demands. Once that level of capacity is installed, costs do not vary significantly with the level of traffic. (Montgomery, Ex. T-84, pp. 47-48; Montgomery, Ex. T-86, p. 23; Wilson, Ex. T-155, p. 33; Andreassi, Ex. T-83, p. 27; Zepp, Ex. T-153; King, Ex. T-104, pp. 27-30) Each firm should be responsible for the costs that it imposes on others; usage-

based rates provide no assurance that this will happen. A company whose outgoing traffic, for instance, is primarily during the busiest hours would contribute much more to costs than it would pay in interconnection charges under a minutes-of-use regime. That would encourage uneconomic entry and be unfair to the terminating company.

- (3) A measured use regime would threaten the state's public policy of affordable, flat-rated local service.

The final strike against a mandatory measured-use compensation structure is that it conflicts with and could ultimately undermine the state's policy in favor of providing telephone customers with the option of flat-rated local service. Adopting mandatory measured service at the wholesale level makes it impossible to adopt a retail rate structure that reflects the wholesale price structure without violating the statutory ban on mandatory measured service. (Murray, Ex. T-135, p. 6; Beauvais, Ex. T-130, p. 12; Zepp, Ex. T-153, p. 5)

USWC's proposed minutes of use rate likely would price new entrant ALECs out of the market for flat-rated local service, thereby insulating incumbents from competition for those customers who want flat-rated service -- a group that would appear to include most customers. USWC argues that any of its competitors would be free to sell at retail flat-rated services that it was buying from USWC at wholesale on a measured basis, and we do not disagree. But that does not mean that such a strategy would be competitively viable. (Montgomery, Ex. T-84, p. 48) The costs of USWC's competitors would be higher by the amount of the access charge, thereby reducing pressure on USWC to maintain low rates. Any firm charging flat rates while paying measured rates for access would be vulnerable to a price squeeze as calling volume increased. (Zepp, Ex. T-151, pp. 13-14; Wilson, Ex. T-155, p. 26)

The minutes of use plan would not only raise costs of competitors but also directly place upward pressure on the incumbents' flat-rated local service, both because of the additional expenses associated with measurement and billing, and the potential that retail rates would have to be raised when the access charges are included in an imputation calculation. (Cornell, Ex. T-140, p. 34; Smith, Ex. T-157, p. 20; Smith, TR., pp. 2330-31; Murray, Ex. T-135, p. 6; Murray, TR., p. 1962; Beauvais, Ex. T-130, p. 12)

In summary, USWC has proposed mandatory measured use as the exclusive compensation mechanism and at a rate that is excessive in relation to the service's cost. Adopting that proposal would throttle the nascent competition in the local exchange market, foreclose the potential benefits that consumers might enjoy from being able to choose among local exchange companies competing for business on the basis of price, service, and technology. Even as it restricted access to competitive options, a mandatory measured rate regime for local interconnection could, through imputation requirements, drive up the incumbent's local rates and undermine flat-rated local service at the retail level. Adopting such a compensation structure is not in the public interest.

**b. Bill and keep as an interim measure**

The Commission will adopt, as an interim measure, the mutual traffic exchange or bill and keep mechanism for compensating local exchange companies for terminating traffic from other LECs. Bill and keep is a simple method for companies to interconnect with one another and exchange services in a way that benefits their customers. It is already in use by the industry for exchange of EAS traffic. In those circumstances where companies with similar technologies interconnect and maintain balanced traffic, bill and keep produces the same result, i.e., no exchange of money, as would the alternatives that rely on specific rates.

This decision to rely on mutual traffic exchange as an interim measure is driven in part by the fact that all price-based compensation approaches developed in this record suffer serious deficiencies as a basis for efficient and fair interconnection. Bill and keep is, to put it simply, the least deficient of the alternatives offered. The Commission is persuaded that, while bill and keep lacks the appropriate price signals that are essential to an efficient competitive telecommunications market, incumbents will not be financially harmed by adopting bill and keep on an interim basis. Any potential harm would not occur until current barriers to competition are eliminated and competitors gain more than a de minimus market share. This order explicitly links the transition from bill and keep to a price-based structure to the implementation of true local number portability and the removal of other competitive barriers.

The primary advantage of mutual traffic exchange as a compensation structure is that, in the near term, it provides a simple and reasonable way for two competing companies to interconnect and terminate each other's calls. Adopting a bill and keep compensation mechanism will let the incumbents and the new entrants focus on the technical aspects of efficient interconnection without concerns over costly measurement or accounting procedures and without having to revisit existing interconnection agreements for EAS. Bill and keep offers the best opportunity to get new entrants up and running, with a minimum disruption to customers and existing companies. (Zepp, Ex. T-151, p. 13)

Beyond the inherent simplicity of bill and keep, it has the advantage of avoiding the pricing issue because in many situations it results in little or no money changing hands. Interconnection is a reciprocal relationship; otherwise, it would be "connection" instead of "interconnection." One company is providing call termination to a second who, in turn, is providing call termination to the first. Regardless of the pricing structure or the prices themselves, no net money would change hands in those situations where two companies are

obtaining identical services from one another.<sup>12</sup> (Cornell, Ex. T-140, p. 26; Beauvais, TR., pp. 1805-06)

We would not adopt bill and keep if it appeared that new entrant ALECs would be imposing more costs on the incumbents than they would be incurring by terminating incumbents' traffic.<sup>13</sup> This might happen if all traffic were from the ALECs to the incumbent LECs. Both would incur the cost of establishing an interconnection, but with no traffic going to the new entrant, the cost incurred by the incumbent provides it no benefit. However, the opponents of bill and keep have not demonstrated that this situation is likely to occur, at least in the near term when bill and keep will be in place. To the contrary, the only evidence on the record favors the theory that traffic will be close to balance.<sup>14</sup> (Wilson, Ex. T-155, pp. 23-25; Montgomery, Ex. T-84, p. 44; Montgomery, Ex. T-86, p. 21; Cornell, Ex. T-140, p. 28)

It is impossible to say exactly what will occur once competition ensues, but every indication at this point is that the new entrant ALECs will be seeking to provide full-service telecommunications. Their customers can be expected to receive calls as well as make calls. Incumbent and entrant, each seeking to satisfy the demands of its own customers, will have

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<sup>12</sup> This is not to suggest that prices are irrelevant when traffic is in balance and no money is changing hands. The structure and level of prices would affect companies' incentives and decisions in many areas, including investment in new capacity, retail rate structure, and marketing strategies. We conclude that limiting bill and keep to an interim period minimizes the adverse effects posited by such incentives and long-term decisions.

<sup>13</sup> This condition is frequently referred to in the record as a "traffic balance." However, since the interconnection costs are primarily fixed (non traffic-sensitive), the most relevant measure of balance is not the volume of traffic but capacity to carry traffic.

<sup>14</sup> If ALECs develop more than a de minimus market share, and the incumbent LECs have evidence that this interim "bill and keep" requirement causes the incumbents competitive harm, they, of course, can file appropriate tariff revisions designed to correct that development.

the same need for interconnection.<sup>15</sup> We find little potential harm and much potential gain to having competition begin under an interim bill and keep arrangement.

c. Future structures for compensation

Adopting bill and keep as an interim measure raises the question of what structure compensation should take over the long term. Specifically, what will follow bill and keep? The Commission expects that future interconnection arrangements will be negotiated with mutually acceptable results once the bargaining position between incumbents and new entrants becomes more balanced. As technical problems such as number portability are resolved and competition becomes more pervasive, compensation -- like every other aspect of interconnection -- will usually be negotiated to the mutual satisfaction of the interconnecting companies. We would be very surprised if every negotiation ended with a bill and keep structure. It certainly is not the Commission's intent in this order to require such a result.

As the number and types of interconnection arrangements increase, bill and keep as a standard interconnection framework is likely to become less and less workable as an exclusive structure for compensation. Situations are likely to arise where two competitors do not want or need exactly the same services, measured in either quantity or quality, from one another. One company might desire to terminate all traffic to another on that company's tandem, but the second may prefer to terminate its traffic at each of the first company's end offices. [Owens, TR., p. 355] These decisions will be made by each company based on economics, technology, and the demands of its customers for quality service and low prices. A bill and keep arrangement that presumes mutual exchange of services will not, over the long term, provide the flexibility to accommodate the diversity that is likely to result from competing local exchange companies, though it may well be used in some situations.

Beyond the near term, competitive local exchange markets will require prices such that companies can both obtain the services they need from each other and receive the compensation that they deserve and require. With price tags attached to various interconnection services, LECs can choose and pay for the services that they need to satisfy

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<sup>15</sup> This prospect of balanced demand for interconnection may not be realized if companies are unable to develop a way to make telephone numbers portable among companies, so that a customer can switch companies without changing telephone numbers. The primary concern about a lack of number portability is its effect on competition. The costs of switching numbers would discourage customers from changing companies and thereby allow the incumbent to maintain above-market prices. However, a secondary concern is that, to the extent new ALEC entrants do attract customers, the traffic might be out of balance. A customer might keep its USWC line (and number) for incoming calls and use an ALEC's line for outgoing calls. The result would be an imbalance of traffic on the ALEC-USWC interconnection, even though the customer's total traffic is in balance. In this example the interconnection imbalance exists only because of a lack of number portability and likely would not continue once numbers become portable.

their own customers. The services that competing companies seek to offer, the markets that they seek to serve, and the technologies they use in the process are all likely to vary among companies.

Price-based mechanisms were proposed in this case, but we are not satisfied that the record here provides a basis to adopt any cost-based interconnection rate. For instance, the costs underlying interconnection are primarily fixed in nature, yet the prices proposed by various parties included usage elements. The USWC proposal departs most from cost in this regard, since it would recover costs through a charge on every minute of use. Even the so-called flat-rated port charge offered as an alternative to bill and keep falls short, in that the charges depend upon a company's use during peak hours. If interconnection costs are fixed, they do not go away if a company does not use the capacity made available by the interconnecting company.

We expect that the telecommunications industry will develop other compensation mechanisms that fit in circumstances where bill and keep does not. To do so, incumbent LECs and new entrant ALECs need to develop further the cost basis for specific rates. Each company has the responsibility to demonstrate that the interconnection rate it would charge is fair, just, and reasonable. At a minimum, the rate should cover the total service long-run incremental cost, or TSLRIC, of the service. The estimates of TSLRIC in this case, however, have been insufficient (see the Cost Studies section of this order). If rates are to be set by the Commission (rather than through good-faith negotiations of market participants, as we would prefer), complete and accurate cost data must be provided. Our lack of confidence in the calculations of USWC's TSLRIC in this case is one factor in our decision to adopt, at least for an interim period, the mutual traffic exchange compensation mechanism.

Any interconnection rates proposed as a replacement for bill and keep also need to reflect the cost structure of the service being provided and in particular the cost structure that is likely to obtain in the future:

The new technologies are less sensitive to call distances and to call usage. Whereas usage rate structures measure only these factors, the underlying costs are becoming relatively more sensitive to the capacity demanded, rather like the "demand charge" in kilowatts in an electric service pricing structure compared to the usage sensitive kilowatt-hours. (Montgomery, Ex. T-84, p. 48)

Charging a use-based rate to recover costs that are primarily fixed in nature is likely to discriminate against certain groups of customers, distort incentives to enter the competitive market, discourage economic efficiency in the design of networks, and prove unsustainable under competition. Use-based rates may be reasonable when customers also have the option of a flat rate, but nothing in this record suggests a circumstance where mandatory measured service interconnection rates would serve the public interest.

In addition, further exploration is required whether TSLRIC is appropriate as a price for interconnection services. It has been argued that interconnection rates should be set at TSLRIC because an incumbent LEC should not be permitted to earn profits from services it provides its competitors. We are not prepared to accept that argument, though we do not reject it at this point. To illustrate that it may be appropriate for rates to exceed TSLRIC, consider the extreme case where every customer is served by an ALEC: Would the backbone network still be provided by the incumbent LEC? Would rates based on the TSLRIC of interconnection be sufficient to pay the costs of that network?<sup>16</sup> These questions are not resolved by the record in this case, and they need to be before reasonable, cost-based interconnection rates can be established.

Elsewhere in this order, we direct both the incumbent and entrant local exchange companies to develop a plan for implementation of local number portability and present that plan to the Commission within nine months of the date of this order. The Commission believes that is an appropriate time to revisit the interim compensation mechanism adopted in this order. We expect that by that time the industry will have negotiated a replacement for the bill and keep mechanism, a replacement that sets prices for services based on the costs of those services. Failing such an agreement, we expect the incumbent LECs to propose a capacity charge that is cost-based, that is supported by reasonable cost studies, and, if proposed interconnection rates provide a contribution above TSLRIC, that justify the existence and magnitude of that contribution.

#### 4. Legal Arguments Raised by Incumbent LECs on Compensation Issues

As noted in the above discussion of the Commission's authority, the incumbent LECs have taken a very legalistic approach in arguments supporting their interconnection proposals. With regard to compensation for the termination of another LEC's local traffic, they argue that the Commission's authority to set rates is extremely limited. They take the position that the Commission cannot order bill and keep, for either intraexchange traffic or ALECs' EAS traffic. They argue that the Commission must approve their proposed interconnection compensation mechanism, and that the Commission's authority is limited to regulating the fairness and sufficiency of the rates of the services they choose to offer. USWC argues that the Commission has no choice but to approve local interconnection access charges which include an interim universal service charge element, because failure to do so will result in a deprivation of USWC's right to an opportunity to earn a fair rate of return.

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<sup>16</sup> The question, viewed from another perspective, is: Would the new entrant ALECs compete with the incumbent LEC in every aspect and component of its service? Or, does there exist a core network integration function that new entrants cannot be expected to provide? If so, the cost of that function would appear to be one that should be recovered in an interconnection rate that exceeds TSLRIC.